

Letter of Findings: 08-0517
Gross Retail Tax
For the Years 2004, 2005, and 2006

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ISSUES

I. Proposed Assessment – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(b); IC § 6-8.1-5-1(c); [45 IAC 15-5-3\(b\)\(8\)](#).

Taxpayers argue that the Department of Revenue's calculation of Gross Retail Tax overstates the actual amount of tax liability.

II. Tax Administration – Fraud Penalty.

Authority: IC § 6-8.1-10-4(a); [45 IAC 15-5-7\(f\)\(3\)](#); [45 IAC 15-5-7\(f\)\(3\)\(A\)](#); [45 IAC 15-5-7\(f\)\(3\)\(B\)](#); [45 IAC 15-5-7\(f\)\(3\)\(C\)](#), (D), (E).

Taxpayers maintain that the Department of Revenue's imposition of the 100 percent fraud penalty is unwarranted.

III. Tax Administration – Jeopardy Assessment.

Authority: IC § 6-8.1-5-1(b); IC § 6-8.1-5-3(a); IC § 6-8.1-5-3(b); IC § 6-8.1-8-2.

Taxpayers claim that the Department of Revenue erred when it issued "jeopardy assessments" without first allowing taxpayers the opportunity to protest the assessment.

STATEMENT OF FACTS

This Letter of Finding addresses objections tendered by two entities; retail taxpayer is a jewelry store located in Indiana, and individual taxpayer is the responsible officer of that Indiana jewelry store. Individual taxpayer owns and operates the jewelry store. The Department of Revenue (Department) instituted an audit of the store. The Department's auditor reviewed certain business records and determined that those records disclosed substantial irregularities in the assessment and collection of gross retail (sales) tax. The records allegedly demonstrated that retail taxpayer failed to collect sales tax on certain transactions and that, during the years under review, retail taxpayer and individual taxpayer incorrectly represented that approximately 80 percent of the jewelry store's retail sales were exempt. The Department requested copies of original invoices but, despite repeated requests, the invoices were not provided. Eventually, the Department subpoenaed the records. When the subpoenaed records were not obtained, the Department sought and obtained a search warrant for the retail taxpayer's business location and individual taxpayer's residence.

Individual taxpayer was determined to be the jewelry store's "responsible officer" because she was responsible for the preparation and submission of the purportedly fraudulent sales tax returns. Individual taxpayer does not challenge the Department's conclusion that she was functioning as the retail taxpayer's responsible officer.

As a result of reviewing the available records and disallowing the claimed exempt sales, the Department issued notices of proposed assessment on the ground that retail taxpayer had reported only four percent of its taxable sales. A protest was submitted on behalf of both retail taxpayer and individual taxpayer challenging the assessment, and the matter was assigned to a hearing officer. An administrative hearing was scheduled in order to permit the taxpayers to explain the basis for their protest, but taxpayers chose not to participate. This Letter of Findings is written based upon the information contained with the protest file and applies with equal force to both retail taxpayer and individual taxpayer.

I. Proposed Assessment – Gross Retail Tax.

DISCUSSION

As with any administrative tax protest, it should be noted at the outset that it is the taxpayers who bear the burden of proof. IC § 6-8.1-5-1(c) states in pertinent part that, "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." The Indiana Administrative Code states "[t]he burden of proving that a proposed assessment is incorrect rests with the taxpayer...." [45 IAC 15-5-3\(b\)\(8\)](#).

The Department's use of the best information available to calculate the proposed assessment is authorized under IC § 6-8.1-5-1(b), which provides in part that "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department."

The Department found that the jewelry store had failed to remit approximately \$400,000 in sales tax. This amount was based upon information contained within the store's records including the general ledger and the

ST-103 sales tax reports. Except for alleging that "no basis exists for the amount of additional sales tax assessed," neither taxpayer has done anything to demonstrate that the approximately \$400,000 assessment is incorrect.

FINDING

Taxpayers' protest is denied.

II. Tax Administration – Fraud Penalty.

DISCUSSION

A 100 percent penalty was assessed because of the substantial disparity between the amount of taxes retail taxpayer received from its customers and the amount of taxes which were forwarded to the Department. IC § 6-8.1-10-4(a) states that, "If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, the person is subject to a penalty. (b) The amount of the penalty imposed for a fraudulent failure described in subsection (a) is one hundred percent (100 [percent]) multiplied by: (1) the full amount of the tax, if the person failed to file a return; or (2) the amount of the tax that is not paid, if the person failed to pay the full amount of tax."

The pertinent Indiana regulation, [45 IAC 15-5-7\(f\)\(3\)](#), states:

A person who files a return which makes a false representation(s) with knowledge or reckless ignorance of the falsity will be deemed to have filed a fraudulent return. There are five elements to fraud.

(A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.

(B) Scienter: This is a legal term meaning guilty knowledge or previous knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purpose of proving fraud.

(C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.

(D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.

(E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

In order to demonstrate fraud, the Department is required to prove from the record each of the above elements set out in [45 IAC 15-5-7\(f\)\(3\)](#). Based upon the substantial disparity between the amount of the retail store's actual taxable sales and the amount of taxable sales reported to the Department along with documented evidence of sales to Indiana customers for which no sales tax was charged, the Department was entitled to conclude that retail taxpayer and individual taxpayer committed a "misrepresentation of material fact," pursuant to [45 IAC 15-5-7\(f\)\(3\)\(A\)](#).

Bearing in mind that the jewelry store is a multi-million dollar business and that individual taxpayer herself is neither a novice nor unsophisticated business person, the Department was entitled to conclude that individual taxpayer – as the store's responsible officer and answerable for the preparation of the sales tax returns – had actual knowledge of the repeated misrepresentations or that, in the alternative, taxpayers exhibited a reckless disregard for the truth. As a result, the Department reasonably concluded that taxpayers exhibited the "scienter" element required under [45 IAC 15-5-7\(f\)\(3\)\(B\)](#).

The Department accepted and relied upon the sales tax returns and taxpayers' representations as to its taxable sales for a period of at least three years. In deciding to impose the 100 percent fraud penalty, the Department was justified in concluding that taxpayers acted with intent to deceive, that the Department had mistakenly relied upon taxpayers' representations, and that the Department was "injured" by failing to collect the amount of sales tax to which it – and by implication the state of Indiana – was entitled. Therefore, the three elements of fraud set out in [45 IAC 15-5-7\(f\)\(3\)\(C\)](#), (D), and (E) are met.

FINDING

Taxpayers' protest is denied.

III. Tax Administration – Jeopardy Assessment.

DISCUSSION

Taxpayers maintain that the Department was not justified in resorting to the "jeopardy assessment" remedy pursuant to IC § 6-8.1-5-3(a). That provision states as follows:

If at any time the department finds that a person owing taxes intends to quickly leave the state, remove his property from the state, conceal his property in the state, or do any other act that would jeopardize the collection of those taxes, the department may declare the person's tax period at an end, may immediately

make an assessment for the taxes owing, and may demand immediate payment of the amount due, without providing the notice required in IC § 6-8.1-8-2.

The Department saw fit to collect the sales tax due by requiring immediate payment of the amount assessed and to forgo the notice provisions set out IC § 6-8.1-8-2. The Department concluded that taxpayers were maintaining two sets of records; one set of records can loosely be categorized as "show to the Department of Revenue" and the second set of records can be loosely categorized as "don't show to the Department of Revenue." The disparate records demonstrate that taxpayers failed to collect and/or remit substantial amount of sales tax. Given the taxpayers' egregious, repeated, and substantial misrepresentations, the Department reasonably concluded that any procedural delay in collecting the amount of tax owed would "jeopardize the collection of those taxes." Taxpayers have failed to meet the burden under IC § 6-8.1-5-1(b) of demonstrating that the Department erred in resorting to the jeopardy assessment remedy available under IC § 6-8.1-5-3(a).

FINDING

Taxpayers' protest is denied.

Taxpayers make peripheral objections to the seizure of business records on the ground that the search warrant "was based in part on incorrect and incomplete facts provided to the Prosecutor by the Department of Revenue's own auditor." Taxpayer also objects to the seizure of the business records on the ground that the seizure caused "taxpayer substantial damage and will cause irreparable harm unless the collection warrants are recalled...." These secondary objections are beyond the purview of an administrative hearing and will not be addressed here.

SUMMARY

Taxpayers' protests are denied in their entirety.

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